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AGENDA ITEM 3a

TO: MEMBERS OF THE INVESTMENT POLICY SUBCOMMITTEE

- I. SUBJECT:** Revision of Equity Real Estate
Revision of Opportunistic Real Estate
Revision of Timber Real Estate
- II. PROGRAM:** Real Estate (Core and Non Core)
- III. RECOMMENDATION:** Approve the reading and recommend to the Investment Committee approval of the revisions to the Statement of Investment Policy for Equity Real Estate, Statement of Investment Policy for Opportunistic Real Estate and Statement of Investment Policy for Timber Real Estate

IV. ANALYSIS:

Staff is requesting the following changes to the Statement of Equity Real Estate:

- Change the name from "Equity Real Estate" to "Global Real Estate."
- Expand the allocation range for Opportunistic Real Estate from 0 – 15% to 0 – 30%.
- Reclassify the Timber Portfolio from Non Core to Core.

Corollary changes to the Statements of Investment Policy for Opportunistic Real Estate and Timber Real Estate are highlighted below.

Global Real Estate Justification

Staff is requesting a change to the name of this policy from "Equity Real Estate" to "Global Real Estate" which is based on two reasons.

First, the Real Estate unit utilizes both equity and debt strategies. An example of a debt strategy is the employment of mezzanine debt.

Secondly, recent revisions to real estate policies brought forth by Staff's ongoing evaluation of the real estate investment markets and opportunity sector also necessitate the need to alter the title. The expansion of both the Core and Non Core's maximum limitation into international investments and the renamed Global (previously Extended Market) Public Real Estate Equity Securities are clear examples that indicate the term "Global" more accurately reflects the identity of the policy and the approach that the Real Estate Staff is taking.

The Equity Real Estate Policy and Equity Real Estate Glossary are included as Attachment 1 and Attachment 2 respectively.

Opportunistic Range Expansion Justification

Staff is requesting an expansion to the allocation range for Opportunistic Real Estate from 0 – 15% to 0 – 30%. By its nature opportunistic investing is primarily tactical, seeking to capitalize on shifting or at times rapidly changing market conditions. Factors that may provide the potential for opportunistic investing include changes to real estate fundamental, capital markets or asset pricing. Currently these factors are converging to provide a large pool of compelling opportunistic investments which fit within the parameters of the Statement of Investment Policy for Opportunistic Real Estate. Opportunistic investing is currently nearing the top (12.0% based on committed capital as of 9/30/05) of the allocation range of 0 – 15%. The proposed policy change would allow Staff to dynamically pursue opportunistic investments -- including investments in our current managers' follow-on funds -- that provide superior risk-adjusted returns. The 0 – 30% range would also be consistent with our Housing and CURE policy ranges, and close to the International Range of 0 – 25%.

Changes to the Statement of Investment Policy for Opportunistic Real Estate

The Statement of Investment Policy for Opportunistic Real Estate ("Opportunistic Policy") is included as Attachment 3. The most meaningful change concerns Asset Allocation (Section IV). For clarity and consistency staff proposes that the allocation range be deleted from the Opportunistic Policy and the range be listed in the Global (Equity) Policy only. In addition, proposed language has been added to clarify that the calculation of ranges is based on market values. Other changes are limited to references to the Equity Real Estate Policy to reflect the proposed name change from Equity Real Estate to Global Real Estate and stylistic changes to avoid confusion or ambiguity.

Reclassification of Timber from Non Core to Core Justification

Staff is requesting the reclassification of the Timber Portfolio from the Non Core to the Core portfolio. Based on recent market conditions the return characteristics of the Timber Portfolio more closely match those of the Core Portfolio. The three-year, five-year and ten-year before fee time-weighted return have been 9.0%, 3.2%, and 7.9% respectively. These returns are below the expectation for the Non Core portfolio.

Changes to the Statement of Investment Policy for Timber Real Estate

The Statement of Investment Policy for Core Timber Real Estate ("Timber Policy") and Core Timber Real Estate Glossary are included as Attachments 4 and 5 respectively. For clarity and consistency staff proposes that the allocation range be deleted from the Timber Policy and the range be listed in the Global (Equity) Policy only. In addition, proposed language has been added to clarify that the calculation of ranges is based on market values. Other changes are limited to the proposed allocation to the Core portfolio and a clarification regarding the Glossary of Terms.

PCA Concurrence Letter

The concurrence letter from PCA referencing the changes listed above is included as Attachment 6.

V. STRATEGIC PLAN:

This change in policy supports Goal VIII of the Strategic Plan: Manage the risk and volatility of assets and liabilities to ensure sufficient funds are available, first, to pay benefits and, second, to minimize and stabilize contributions.

VI. RESULTS/COSTS:

The name change from "Equity Real Estate" to "Global Real Estate" results in a more accurate reflection of the investments and strategies utilized by the Real Estate Unit.

The expansion of the Opportunistic Real Estate range allows for greater flexibility in pursuing superior risk-adjusted investments in the Non Core sector.

The allocation of the Timber Portfolio to Core more accurately reflects the return characteristic of that portfolio.

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